

Office of Chief Counsel
Internal Revenue Service

memorandum

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date: MAR 19 1999

to: Chief, Examination Division, Southern California District
Attention: Josephine M. Robinson, Group Manager
Pablo Fernandez, Revenue Agent
Examination Group CE 1102, Santa Ana

from: District Counsel, Southern California District, Laguna Niguel
June Y. Bass, Assistant District Counsel
Jenny A. Moon, Attorney *JAM*

subject: Taxpayer: [REDACTED] (formerly [REDACTED])
Taxable Year Ended May 31, [REDACTED]

THIS ADVICE CONSTITUTES RETURN INFORMATION SUBJECT TO I.R.C. § 6103. THIS ADVICE CONTAINS CONFIDENTIAL INFORMATION SUBJECT TO ATTORNEY-CLIENT AND DELIBERATIVE PROCESS PRIVILEGES AND IF PREPARED IN CONTEMPLATION OF LITIGATION, SUBJECT TO THE ATTORNEY WORK PRODUCT PRIVILEGE. ACCORDINGLY, THE EXAMINATION OR APPEALS RECIPIENT OF THIS DOCUMENT MAY PROVIDE IT ONLY TO THOSE PERSONS WHOSE OFFICIAL TAX ADMINISTRATION DUTIES WITH RESPECT TO THIS CASE REQUIRE SUCH DISCLOSURE. IN NO EVENT MAY THIS DOCUMENT BE PROVIDED TO EXAMINATION, APPEALS, OR OTHER PERSONS BEYOND THOSE SPECIFICALLY INDICATED IN THIS STATEMENT. THIS ADVICE MAY NOT BE DISCLOSED TO TAXPAYERS OR THEIR REPRESENTATIVES.

THIS ADVICE IS NOT BINDING ON EXAMINATION OR APPEALS AND IS NOT A FINAL CASE DETERMINATION. THIS MEMORANDUM IS ADVISORY AND DOES NOT RESOLVE SERVICE POSITION ON AN ISSUE OR PROVIDE THE BASIS FOR CLOSING A CASE. THE DETERMINATION OF THE SERVICE IN THE CASE IS TO BE MADE THROUGH THE EXERCISE OF THE INDEPENDENT JUDGMENT OF THE OFFICE WITH JURISDICTION OVER THE CASE.

This is in response to your request for advice on properly completing a Form 872-S, Consent to Extend the Time to Assess Tax Attributable to Items of an S Corporation. This advice is being forwarded to Field Service for post-review.

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ISSUES

1. Was [REDACTED] [hereinafter, the "Taxpayer"] a TEFRA subchapter-S corporation for the taxable year ended May 31, [REDACTED]?
2. Who may execute a Form 872-S on behalf of the Taxpayer for the taxable year ended May 31, [REDACTED]?
3. What is the correct name of the Taxpayer to appear on the Form 872-S, where subsequent to the taxable year at issue, the Taxpayer changed its name to [REDACTED] and became a member of a consolidated group?

For the reasons set forth below, it is our opinion that:

1. Yes, the Taxpayer was a TEFRA subchapter S corporation for the taxable year ended May 31, [REDACTED]
2. [REDACTED] as the Taxpayer's Tax Matters Person, is the proper party to execute the Form 872-S on behalf of the Taxpayer.
3. On Form 872-S, the Taxpayer's name should appear as "[REDACTED] formerly known as [REDACTED]"

FACTS

The Taxpayer, a California corporation, was in the business of [REDACTED]. The Taxpayer was a subchapter S corporation with [REDACTED] shares of common stock outstanding, of which [REDACTED] shares were held by the [REDACTED] Trust and the remaining [REDACTED] shares were held by the [REDACTED] Trust. The [REDACTED] Trust is a qualified subchapter S trust.

With respect to the [REDACTED] Trust, [REDACTED] and [REDACTED] husband and wife, were co-trustees with the power to revoke or modify the trust, to receive net income, and to invade the corpus. Upon the death of the first trustee, the trust agreement¹ provided for the following:

1. The [REDACTED] Trust became irrevocable and unmodifiable;
2. The trust assets were divided into two separate trusts--the Exemption Trust and the Survivor's Trust;

¹ We are assuming that the [REDACTED] Trust agreement that was provided to us is a complete copy, and that the trust agreement was not amended, as no amendment was given to us.

3. The surviving trustee had the right to receive all net income from both the Exemption Trust and the Survivor's Trust; and

4. The surviving trustee had the right to invade the corpus of both the Exemption Trust and the Survivor's Trust.

As a result of [REDACTED]'s death, [REDACTED] became the sole trustee with the foregoing rights.

On [REDACTED], [REDACTED]² [REDACTED] [hereinafter, "[REDACTED]"], a non-S corporation, purchased the trusts' shares in the Taxpayer for \$ [REDACTED]. Consequently, (1) Taxpayer's S-status was terminated, (2) Taxpayer became a member of [REDACTED]'s affiliated group and was included in the consolidated tax return filed for taxable year ended December 31, [REDACTED], and (3) Taxpayer's name was changed to [REDACTED].

The Taxpayer filed a U.S. tax return, Form 1120S, for the short tax year ended [REDACTED]. The tax return identified "[REDACTED]" as the designated Tax Matters Person [hereinafter, "TMP"].

DISCUSSION

I. The Taxpayer was a TEFRA Subchapter S Corporation.

For tax years beginning after December 31, 1982, the administrative provisions of the TEFRA³ partnership rules applied to S corporations that were required to file a return under I.R.C. § 6037(a). I.R.C. § 6244 (1995) (repealed by the Small Business Job Protection Act of 1996, P.L. 104-188, for taxable years beginning after December 31, 1996); Temp. Treas. Reg. §§ 301.6241-1T(a), (c). An exception from TEFRA procedures existed for "small" S corporations for any tax year for which the due dates of the corporate returns were on or after January 30, 1987. Temp. Treas. Regs. § 301.6241-1T(c)(2). A "small" S corporation consisted of five or fewer shareholders, each of whom was a natural person or an estate.

In the present case, Taxpayer was an S-corporation required to file a return under I.R.C. § 6037(a). Both shareholders of the Taxpayer were trusts, which are not natural persons or estates. Thus, even though the Taxpayer had only two shareholders, Taxpayer did not qualify under the "small" S corporation exception to the TEFRA procedures. In other words, Taxpayer was a TEFRA subchapter S corporation.

II. [REDACTED] has the authority to sign the Form 872-S on behalf of the Taxpayer.

² [REDACTED] and the two trusts executed the stock purchase agreement on [REDACTED] [REDACTED], but the sale was not completed until [REDACTED], [REDACTED].

³ The Tax Equity and Fiscal Responsibility Act of 1982.

Generally, I.R.C. § 6229(a) requires the IRS to assess taxes attributable to any partnership item (or affected item) within three years of the later of the date the partnership return was filed or the date the return was required to be filed (without regard to extensions); however, the Service and the TMP (or any other authorized person) may agree to extend the three-year period. I.R.C. § 6229(b)(1)(B); Temp. Treas. Reg. § 301.6229(b)-1T. The three-year rule was made applicable to S corporations by I.R.C. § 6244 (repealed).

The TMP is the statutory representative of the TEFRA entity in its dealings with the Service. In the context of a TEFRA partnership, the partnership may designate, as the TMP, any person who was a general partner in the partnership at some time during the taxable year for which the designation was made, or as of the date of the designation. I.R.C. § 6231(a)(7); Treas. Reg. § 301.6231(a)(7)-1(a). The designation could be made on the partnership return. Treas. Reg. § 301.6231(a)(7)-1(c). If no designation was made by the TEFRA partnership, the Service designated the general partner with the largest profit interest as the TMP; where there was more than one such partner, the Service designated the general partner whose name appeared first alphabetically. I.R.C. § 6231(a)(7); see I.R.C. § 6231(d).

Analogously, a TEFRA corporation may designate a shareholder as the TMP. If no designation was made, the Service designated the largest shareholder; if there was more than one such shareholder, the shareholder whose name appeared first alphabetically was the TMP. Gold-N-Travel, Inc. v. Commissioner, 93 T.C. 618,622 (1989).

In the present case, the Taxpayer's return identified "[REDACTED]" as the TMP. It may appear that because "[REDACTED]" is not a shareholder of the Taxpayer, she can not serve as the TMP. However, even though "[REDACTED]" is not an outright shareholder, she is a "deemed shareholder" under I.R.C. § 1361 and I.R.C. §§ 671-79, and thus can serve as Taxpayer's TMP.

The Taxpayer is an S-corporation defined under I.R.C. § 1361(a). I.R.C. § 1361(c)(2)(A) lists the trusts that are permitted as shareholders, including a trust which is treated under the grantor trust provisions of I.R.C. §§ 671-79 as a trust owned by an United States citizen or resident. I.R.C. § 1361(c)(2)(B) provides that in the case of a grantor trust, the "deemed owner" is to be treated as the shareholder.

In the case at hand, the "[REDACTED]" Trust was a grantor trust. The Internal Revenue Code does not define a grantor trust, but basically, a grantor trust is ignored for tax purposes and the grantor is treated as the appropriate taxpayer when he retains beneficial enjoyment of the trust's corpus and income, and the power to control and liquidate the trust either unilaterally or with the concurrence of someone who is not an "adverse party." I.R.C. § 674(a); United States v. Buttorff, 761 F. 2d 1056 (5th Cir. 1985). An adverse party is defined as "any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust." I.R.C. § 672(a). In the present case, the "[REDACTED]" Trust was a grantor trust, in which "[REDACTED]" retained substantial rights, such as

the right to receive income, to invade the corpus, and to revoke and modify the trust (until the death of the first trustee, at which time, the trust became irrevocable and not subject to amendment).

Upon [REDACTED]'s death, [REDACTED] had substantial powers to qualify her as a deemed owner. I.R.C. §§ 673-77 describes situations where the grantor is treated as the deemed owner. I.R.C. § 678 describes situations where someone other than a grantor is treated as the deemed owner. In the case at hand, it is unclear whether [REDACTED] was a grantor of the [REDACTED] Trust because we do not know whether the assets that were placed into the trust was separate or community property. But given her substantial powers to invade the corpus and to receive income, [REDACTED] is a deemed owner of the [REDACTED] Trust, regardless of whether she is a grantor or not, under I.R.C. § 674 and 677 (if she is a grantor) and I.R.C. § 678(a)(1) (if she is not a grantor).

Given that [REDACTED] is the deemed owner of the [REDACTED] Trust, she is treated as a shareholder under I.R.C. § 1361(c)(2)(B). Thus, she is able to serve as Taxpayer's TMP, in which capacity she has the authority to execute the Form 872-S on behalf of the Taxpayer.

III. The Proper Corporate Name to Appear on Form 872-S

In the taxable year at issue, the Taxpayer was not a member of [REDACTED]'s affiliated group; although Taxpayer later joined [REDACTED]'s group, the Taxpayer, not [REDACTED] is the proper party to extend the statute of limitations with respect to the taxable year at issue. Thus, the proper corporate name to appear on the Form 872-S is, "[REDACTED] formerly known as [REDACTED]"

CONCLUSIONS AND RECOMMENDATIONS

1. Taxpayer was a TEFRA subchapter S corporation in taxable year ended May 31, [REDACTED]
2. [REDACTED] as the Tax Matters Person, has the authority to execute the Form 872-S on behalf of the Taxpayer.
3. Taxpayer's name should appear as, "[REDACTED] formerly [REDACTED]"

Lastly, we recommend that you double-check all corporate and trust names with tax returns, articles of incorporation, and any other documents that may be in your possession.

If you have any questions, please feel free to call Jenny Moon at (949) 360-3431.